

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

JUL 23 1999

In the Matter of)	
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	
Access Charge Reform)	CC Docket No. 96-262

COMMENTS OF U S WEST, INC.

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I. INTRODUCTION AND SUMMARY

On May 27, 1999, the Commission adopted its Seventh Report and Order (R&O) and Thirteenth Order on Reconsideration in CC Docket No. 96-45 and Fourth Report and Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking (FNPRM). The purpose of these Orders and the Rulemaking was to continue the implementation of the long-delayed "explicit" universal support mechanisms for non-rural Local Exchange Carriers (NRLECs).¹ In this FNPRM (and in a companion FNPRM in CC Docket Nos. 96-45 and 97-160 relating to the forward-looking economic cost model) the Commission seeks additional input on items related to the NRLEC explicit mechanism.

¹ The Telecommunications Act of 1996 directed the Commission, by November 7, 1997, to issue an order to "implement the recommendations of the Joint Board ... [and] defin[e] the services that are supported by Federal universal support mechanisms and a specific timetable for implementation." In its first Report and Order in CC Docket No. 96-45, the Commission defined supported services and scheduled implementation of the new NRLEC support mechanism for January 1, 1999. In a subsequent order [cite] the Commission delayed this implementation until July 1, 1999. In the Present Order the Commission proposes further delay until January 1, 2000.

Unfortunately, the Commission's proposals would eviscerate the goals of universal service to make support explicit and sufficient and to provide ubiquitous, affordable basic service. The funding framework outlined in the 7th R&O and 13th Order on Reconsideration does not meet the universal service goals and objectives mandated in the Telecommunications Act of 1996.² The plan that the Commission has endorsed contains two elements which have no foundation in the 1996 Act, and will frustrate many of its objectives:

- The Order directs that the new fund should not be "substantially larger" than the currently existing fund, and
- The Order provides that recipients should be "held harmless" for their current receipts from the fund.

Taken together these two elements will guarantee that the clear directions of Congress will not be achieved, in direct violation of the 1996 Act. The Commission should be aware that if they continue down the path indicated in the instant R&O, that they will be sending clear signals to NRLECs serving large numbers of rural customers that they must reconsider their ability to serve these areas in the new market environment.

Moreover, the delay that has been experienced, to date, in implementing the important universal service elements is without substantial justification and has been harmful to the cause of universal service. In addition, several problems with the instant R&O, as well as problems in finalizing the forward-looking cost model could further delay implementation of new explicit high-cost funding.

² We are, however, pleased that the Commission has reconsidered the 75/25 funding provisions of its prior plan. This is a positive step that should allow the federal

Finally, recent changes and trends with the Commission's Synthesis Model (SM) are quite troubling. These concerns are more fully stated in U S WEST, Inc.'s (U S WEST) comments in the other FNPRM which are being filed concurrently with these comments. Briefly, however, the many changes that have been made recently in the SM, apparently with the intent of reducing the level of cost generated by the SM in a misguided effort to reduce the size of the fund, appear disingenuous at best and extremely dangerous at worst to such related issues as access reform and unbundled network element (UNE) pricing. We are also concerned that the continual changes in the SM make it difficult, if not impossible, to analyze the impact of various funding scenarios on which the Commission seeks comment, and suggests further delay in finally implementing the NRLEC funding mechanisms.

In the following Section, U S WEST will outline the basic principles that we believe should guide the Commission in implementing a NRLEC explicit support mechanism which will accomplish the directives and intent of Congress. In Section III of these comments U S WEST will respond to the specific items on which the Commission has requested comment in the FNPRM.

II. PRINCIPLES THAT MUST GUIDE THE ESTABLISHMENT OF THE NRLEC MECHANISM

A. The plan that the Commission Finally Adopts Must Carry Out the Clear Directives of the 1996 Act

Section 254 of the Act provides guidance on the size of the new support mechanisms:

- Support must be "specific, predictable and sufficient." 254(b)(5)

mechanism to address the needs of states with large numbers of high-cost customers and relatively few lower-cost customers.

- “Any such support should be explicit.” 254(e)

Support for high-cost customers of NRLECs today is comprised primarily of implicit support hidden in the rates for services. Business customers subsidize residence customers, urban customers subsidize rural customers and access charges subsidize local rates. This rate and support structure evolved over many years and was predicated on a monopoly market environment. The current Universal Service Fund (USF) likewise evolved during a time of local service monopoly, and counted on these implicit supports to subsidize the high-cost customers of NRLECs. The current USF provides two funding schedules for local exchange carriers (LECs). LECs that serve fewer than 200,000 lines in a Study Area receive 60% of their embedded cost over 115% of the nationwide average from the fund, and through a sliding scale, up to 100% of their costs above 250% of the nationwide average. In contrast, LECs serving over 200,000 lines in a study area receive only 10% of their embedded costs over 115% of the national average.³ During the monopoly environment of the past there was a good reason for this difference. The larger companies generally had low-cost urban areas to spread the cost of serving more remote high-cost areas over. Generally, the smaller companies served mostly rural territory and lacked the ability to cross subsidize.⁴ In the new competitive market environment, however, the ability to cross-subsidize high-cost rural areas with low-cost urban areas is rapidly disappearing, and the large LECs are

³ While there is not an exact correlation between the over/under 200,000 line regime and the Commission's “rural”/“non-rural” distinction, any carrier with over 200,000 lines would clearly be categorized as a NRLEC.

⁴ Indeed, in many cases “Independent” telephone companies were formed to serve areas deemed too costly to serve by the old Bell System.

now no different in their needs for external support for their high-cost rural areas than the small LECs.

The Commission's determination that the new support mechanism should not "significantly" increase explicit support beyond current levels leaves large amounts of prohibited implicit support in LEC rate structures, both state and interstate. The 1996 Act has as its central premise: the introduction of competition into local telephony. Congress correctly understood that competition and cross subsidy are antithetical.

It is worth noting that Section 254 does not state that the new explicit mechanism should be set "not significantly higher" than the old mechanism until some predetermined level of local competition is reached. It simply states that support should be "explicit" and "sufficient." There is good reason for this, for the Act sought to develop efficient local competition. By leaving massive amounts of subsidy in LEC rate structures, competitors may be incorrectly incited to enter markets where prices are artificially set above cost, and avoid entry into markets where rates are subsidized.⁵ Congress wanted subsidies removed and made explicit before local competition was introduced – not after.

In constraining the new fund to be not significantly larger than the old, the Commission and the Joint Board rely on vague and generalized assumptions about the lack of local competition. Absent is any data or analytical support for the level of competition that leads to this conclusion. NRLECs have negotiated hundreds of interconnection agreements, and have lost hundreds of thousands of high-margin business lines to competitive providers. When parties speak of the lack of competition,

they are generally speaking of competition for subsidized residential customers. If the Commission is to artificially constrain the fund size below that which is ultimately "sufficient," then it must have some factual basis for this determination and a methodology for transitioning to a fund that could be justified as being sufficient. The Commission has not done this and, as explained above, even if they had this would violate the clear directives of Congress.

A constrained fund size could still accomplish a portion of the Congressional intent for affordable service in high-cost areas if the limited funds were allowed to flow to those areas most in need of support. As demonstrated by U S WEST on the record in CC Docket 96-45, many customers cost more than \$100 per month to serve.⁶ U S WEST also demonstrated that the ratio of customers costing over \$100 per month to the total number of customers varies widely among the states.⁷ If a constrained fund were allowed to flow to those customers and states which were most in need of support to maintain affordable rates, then those customers would at least receive some of the protection that Congress had envisioned.

The "hold-harmless" provisions in the Order effectively eliminate any possibility of a constrained fund achieving Congressional intent. Indeed, the math is quite straightforward and compelling: if the fund is to be no larger than at present, and if everyone is to get no less than they presently receive, then there is absolutely no change in what

⁵ The absence of significant competitive alternatives for residential customers is due, in part, to subsidized prices.

⁶ In making these observations U S WEST used outputs from the HAI model which the Commission had found understated cost. Thus, these results provide a conservative view of support requirements.

⁷ For example, in South Dakota one customer in 20 costs in excess of \$100, while in New Jersey the ratio is one in 36,000.

anyone gets. Could it be that over three years of time and tens (if not hundreds) of millions of dollars in SM development and advocacy costs have been spent merely to maintain the status quo? Was this what Congress intended? We think not.

The Commission's conclusions in this R&O represent a marked change from the findings in the initial Universal Service R&O issued in May of 1997. In Paragraph 55 of that R&O the Commission states:

"Finally, we reject proposals to establish a principle to minimize the size and growth of the universal service fund. Although we take measures in this Order to maintain the size of the universal service support mechanisms at a level that is no higher than necessary to effectuate a comprehensive federal universal service policy, we note that section 254(b)(5) requires the Commission to ensure that there are predictable and sufficient federal and state mechanisms to preserve and advance universal service. In accordance with this principle, we decline to adopt measures that may restrict our ability to comply with this mandate."

What happened between May 1997 and June 1999 that so radically changed the Commission's view of its mandate under the 1996 Act? From our view on the sidelines, it is U S WEST's perception that the overpowering influence of regulators from low-cost states (who would rather not see money flow from their states to higher cost states) and long distance carriers (who likewise would rather not pay into a fund) have caused the Commission to adopt a lowest common denominator approach that falls far short of the "affordability" and "sufficiency" standards. It is, however, the role of the federal government to resolve these differences and to implement the intent of Congress. We urge the Commission to return to the view of its role articulated in the 1997 R&O and to establish a workable and lawful explicit funding mechanism for NRLECs.

At a minimum, the Commission must define an acceptable amount of funding increase above current levels to accomplish the clearly stated goals of the Act. Chart I,

below, clearly demonstrates the insufficient nature of the Joint Board's recommendation which the Commission proposes to adopt. The current USF provides \$83 million of explicit support to the NRLECs other than the Puerto Rico Telephone Company.⁸ This is the amount that the Commission tentatively concludes to be "sufficient" in the context of Section 254 of the Act. On June 16, 1999, the Commission released results from the SM using the recommended input values.⁹ We have taken the wire center results provided by the Commission, and applied funding benchmarks of 115%, 125%, 135% and 150% of nationwide average cost. We have also incorporated multiple alternatives for the per-line amount that the Commission has tentatively concluded that each state should fund to assure that states lacking in significant numbers of low-cost customers receive sufficient federal funding.

Chart I
Fund Size With Wire Center Targeting

Benchmark	State Per-Line Amount				
	\$0/mo.	\$1/mo.	\$2/mo.	\$4/mo.	\$6/mo.
115 %	\$5.1B	\$3.6B	\$2.5B	\$1.1B	\$0.5B
125%	\$4.5B	\$2.9B	\$2.0B	\$0.7B	\$0.3B
135%	\$4.0B	\$2.5B	\$1.6B	\$0.5B	\$0.2B
150%	\$3.4B	\$2.0B	\$1.1B	\$0.4B	\$0.1B

Source: FCC Data Release June 16, 1999

⁸ The Puerto Rico Telephone Company receives USF support of approximately \$120 million.

⁹ As mentioned previously, and as detailed in our comments in the model FNPRM which are being filed concurrently, U S WEST believes that the current version of the SM and inputs seriously understates the forward looking cost of serving rural areas. Nonetheless we are providing this summary to demonstrate that the current USF falls seriously short of meeting the "sufficiency" test of the Act.

As can be clearly seen in Chart I, even if the benchmark were set at 150% of forward-looking cost and the state per-line contribution amount were set at \$6 per line per month, the current \$83 million¹⁰ USF would provide barely half of the necessary funding (\$0.1 billion). If the per-line amount were set at \$2 per line per month and the 150% benchmark were used, the minimum required fund size would be well over \$1 billion. As will be more fully developed shortly, parity between rural consumers served by NRLECs and RLECs suggests that the benchmark should be no greater than 115%. With the 115% benchmark and \$2 per-line amount, the Commission's own data suggests that the minimum fund size would be \$2.5 billion.

It is interesting to note how the amount of funding necessary to support affordable rural service has changed in the Commission's rhetoric over time. In July of 1996, then Chairman Reed Hundt stated:

"So how big is the universal service toolbox? It's hard to make any estimates at this time with precision. But in very rough terms, my personal guess is someplace between \$6 and \$12 billion dollars. The largest piece of that would be for high-cost residential rate assistance."¹¹

It is a long way between \$6 - \$12 billion and \$83 million.

The Commission's own SM supports Chairman Hundt's prophetic estimate. Chart I shows that if no state per-line amount were included (which would equate to a total, or intrastate plus interstate fund requirement) and a 115% cost benchmark were

¹⁰ The Commission's June 16, 1999 Data Release indicates that the current fund receipts for the 93 NRLECs for which data is presented is \$83 million.

¹¹ Speech of Reed Hundt before the Great Lakes Conference of Public Utilities Commissioners and Mid-Atlantic Conference of Regulatory Utility Commissioners, July 8, 1996, Cleveland, Ohio.

used, the total fund size for NRLECs using the SM data would be \$5.1 billion.¹² This amount is also similar to the NRLEC fund size predicted by both the BCPM3 and HAI 5.0 models using the Commission's "common inputs." When run with these inputs, both models produced a total fund size of approximately \$4.5 billion using a revenue benchmark of \$31 residence and \$51 business.¹³

A \$2 billion+ NRLEC interstate high-cost fund would not be outside of the realm of reason or political correctness. It would put this fund roughly at parity with the Schools and Libraries fund,¹⁴ and would allow the Commission to claim that, at least within the view of costs as expressed by their SM, this level of funding would be consistent with the clear directives of the 1996 Act.

It has been argued by some (including the Commission in the instant R&O) that averaging support at the study area level will somehow make the current \$83 million of USF "sufficient" to accomplish the directives of the Act. This of course could not be the case upon later legal review, since the averaging of costs across the study area (which for many NRLECs is as large as an entire state) would include substantial implicit support that the Act sought to eliminate.

¹² U S WEST has also been able to run the Commission's SM to aggregate support requirements at the "cluster" level. This run provides a more accurate estimate of the true need of customers in high-cost rural areas for support – either implicit or explicit. Using this level of aggregation and the Commission's SM and data (which, as previously stated we believe seriously underestimates cost) the required support is \$7.9 billion.

¹³ It is interesting to note how the potential fund size has varied in public comments of the FCC leadership.

¹⁴ Correspondence from key Congressional leaders indicates that the high-cost fund was the primary intent of Congress, and the Schools and Libraries fund was a later add-on.

Finally, the Commission must realize that if they choose to stay with this level of explicit high-cost funding for NRLECs then they will be signaling at least two other major policy changes:

- In early policy statements regarding implementation of the 1996 Act, the Commission referred to the Interconnection, Access Reform and Universal Service proceeding as a “trilogy” or a “three-legged stool.” Both the Interconnection and Access Reform Orders deferred concerns about the impact on current implicit support to the Universal Service decision. Given the miniscule size of the high-cost fund for NRLECs, the Commission has chopped off one leg of the stool, meaning that the other legs too must be shortened or it will not stand. In particular, since the NRLECs must continue to rely almost exclusively on implicit support, the plans for significant reductions in access charges (including the movement of access prices towards forward-looking economic cost) must be put on indefinite hold unless and until sufficient explicit support mechanisms are implemented.
- The Commission will also be signaling “non-rural” LECs who serve significant numbers of customers in high-cost rural areas that they should exit these markets. In the instant R&O, the Commission comments on how implicit support from low-cost areas to high-cost areas will not be sustainable. We agree. The dual nature of the Commission’s policy framework, where LECs who happen to be classified as “rural” do receive adequate and sufficient funding, adds further emphasis to this market direction.

B. If the Commission Perceives that Political or Other Pressures Require that Aggregate Fund Size Be Unlawfully Limited, Then a Better Funding Structure Should Be Implemented and the Fund Size Adjusted Through the Level of the Funding Benchmark and the Per-Line Contribution Amount

U S WEST is concerned that many of the recent changes in the Commission’s SM have been made for the purpose of reducing the forward-looking cost of providing

service as a way to reduce the size of the fund. This is dangerous since not only will it result in a fund size which is insufficient, but there will be temptations to inappropriately use the SM and these understated costs in upcoming access reform proceedings and reviews on UNE prices.

If the fund is to be constrained below what is fully "sufficient," then there must be some mechanism to assure that that funds available are targeted to those customers who need support the most. In prior presentations and comments on the record in CC Docket 96-45, U S WEST advocated a plan that utilized a "super-benchmark" to direct needed federal support to the most costly customers. While we still believe that this would be a superior solution, it is possible to adjust the plan presented in the instant R&O to achieve these goals.

The plan proposed by the Commission in this R&O relies on a single benchmark above the forward-looking cost to determine the support amount. It also incorporates a maximum per-line contribution that ratepayers within a state should be expected to pay in order to determine the portion of support that should come from a federal fund. Using these two variables – the level of the benchmark and the maximum per-line contribution amount – the Commission could adjust the fund size until it reaches the pre-ordained level. Chart I illustrates how these two variables could be adjusted in tandem to impact the overall size of the fund.

Of necessity, the more specific targeting of limited support dollars to benefit the highest cost customers will be in conflict with the Commission's objective to have current fund recipients receive no less federal support than they currently do. The 1996 Act says nothing about holding harmless. However, recognizing that the Commission

proposed these provisions to protect states from rate shock caused by sudden decreases in federal support, U S WEST respectfully suggests that this provides additional support for increasing the funding level beyond the current \$83 million for NRLECs as developed in the prior section.

C. Support Must Be Targeted to the Smallest Practical Geographic Area

The 1996 Act directs that support for high-cost areas should be explicit. It is also a mathematical fact that the larger the area over which support is "targeted," the smaller will be the resultant fund size. However, as the size of the targeting area grows, additional implicit support is created as the highest-cost customers are averaged in with low-cost customers. For this reason the Commission should avoid the temptation to manage the fund size by increasing the targeting area.

In prior advocacy, U S WEST had argued that support should be targeted to the smallest feasible geographic area such as a "grid" or a CBG. This assured that high-cost customers would receive funding support sufficient to cover their cost, and minimize implicit supports. Ultimately we believe that this type of precision in targeting will be necessary, particularly as growth occurs in high-cost areas and carriers will need sufficient support to justify their construction costs. In light of the present direction of this proceeding, however, we believe that some form of targeting at the Central Office (CO) level could be made to work if one important adjustment to the provision of support were to be made.

COs, which are also sometimes referred to as "wire centers," are located so as to minimize the total wiring cost within a serving area. Typically COs are located in the center of towns. Customers located close to the CO utilize short wire "loops" and are

relatively inexpensive to serve. Customers who are located many miles from the CO become increasingly expensive to serve as the length of their wire loop increases. It is important to realize that even in the COs with the highest **average** cost to serve, there are customers located close to the CO whose service costs less than \$20 per month.

In a CO where the average cost was \$100 per month, there obviously must be customers who cost significantly more than \$100, since those "downtown" customers cost under \$20. If support to all customers in the CO were based on this \$100 average, then some customers would potentially receive a windfall of several times their cost in "support" payments. This could also lead to a harmful form of arbitrage where carriers could be incented to market heavily to the downtown customer to receive a financial windfall.

To address this problem, U S WEST would suggest that within each CO that qualified for support, a "no-support zone" be defined. The no-support zone could be as simple as a circle drawn around the CO at approximately the distance where the loop cost would exceed the funding benchmark. It could also use "Base Rate Areas" defined by some states in their Local Exchange Tariffs, or some other pre-defined measure. The determination and administration would be best left to the States. The potential for wasteful arbitrage would be eliminated, and competition in the downtown areas would proceed without the perverse impacts of unnecessary support payments. Support would be targeted to those customers located outside of the no-support zone. The support amount would more closely approximate the cost of serving the remote customers, and competitors would be more likely to construct facilities to serve these

higher cost customers (for additional thoughts on targeting see *A COMPILATION OF "BEST PRACTICES" TO IMPLEMENT THE TELECOMMUNICATIONS ACT OF 1996*, The National Regulatory Research Institute, April, 1999). There are several ways in which this could be accomplished.

The preferred and most accurate way would be to take each CO where the average cost exceeded the funding benchmark and conduct a more disaggregated cost analysis. The cost for serving all customers located outside of the no-support zone would be computed, and the average of these costs would be provided to carriers serving customers outside of the no-support zone. A second-best, and less accurate, method would be to take the total amount of support determined at the CO level and dividing that by the number of customers located outside of the no-support zone. This would provide the same amount of funds (and rely on implicit support from the downtown customers), but would avoid the problems of arbitrage and provide a higher support amount to the remote customer's service.

D. Support Must Go to the Provider of the Communication Facilities

It is U S WEST's strong belief that when one carrier uses the facilities of another carrier through resale or the use of UNEs, support payments must go to the facilities provider. In the FNPRM, the Commission raises a number of legitimate questions about the meaning and application of Section 254(e), which states:

"A carrier that receives such support shall use that support only for the provision, maintenance and upgrading of facilities and services for which the support is intended."

Since purchasers of UNE and/or resale services do not provide, maintain or upgrade the facilities used for the service, then they should not receive the support payment. This is not to say that the user of UNE or resold facilities should not receive the benefit of the support payment to facilities provider. They should. The UNE price should be adjusted to reflect the average per line support for the UNE zone. Resale prices currently reflect the implicit support presently provided. Failure to adopt these provisions will lead to two serious problems. First, carriers could be attracted to serve certain areas and customers for the purpose of receiving support payments and a potential financial windfall. Second, and potentially much more serious, failure to adequately compensate the facilities provider for their legitimate costs will ultimately result in strong incentives for carriers to not invest in facilities in high-cost rural areas.

E. Some Form of Parity Must Be Preserved Between Rural Customers Served by “Non-Rural” Telephone Companies and Those Served by “Rural” Telephone Companies

While the Act defines Rural and Non-Rural telephone companies, it is for purposes other than the relative distribution of universal service support. Section 214(e) differentiates between rural and non-rural companies for purposes of the designation of more than one Eligible Telecommunications Carrier for the receipt of high-cost support. Section 252 differentiates for the application of certain network opening and unbundling obligations. Significantly, however, these terms are nowhere to be found in Section 254. Section 254 speaks only of “specific, predictable and sufficient.

As mentioned previously, under the monopoly-based USF, smaller carriers received significantly larger payments than larger carriers because of their lack of low-

cost urban customers to provide implicit support. Yet, as competition enters the lower-cost markets the large companies become not much different than their smaller siblings in the inability to geographically cross-subsidize their high-cost rural customers.

Rural telephone companies receive support for **embedded** costs in excess of 115% of nationwide average embedded cost. Under the provisions of the R&O, Non-Rural telephone companies would receive support for **forward-looking costs** in excess of a range of **115% to 150%** of nationwide average forward-looking cost (from a cost model that U S WEST believes seriously understates cost).

The case for some rough parity between Rural telephone companies and Non-Rural telephone companies becomes even more compelling when viewed from the eyes of the rural consumer. The title "Non-Rural" is somewhat of a misnomer since all Non-Rural telephone companies serve rural customers, some more than others. It is often the case that in rural parts of a state neighboring communities are served by different telephone companies. It is not uncommon that one community is served by the Non-Rural telephone company while the other is served by a Rural telephone company. The availability or quality of services available to consumers in neighboring towns should not be determined by the type of telephone company that happens to serve their community. This arbitrary discrimination is contrary to the intent of the 1996 Act.

The underfunding of universal service outlined in the R&O will exacerbate this problem. By forcing Non-Rural telephone companies to continue to rely on implicit support from urban areas, carriers will be forced to focus their limited capital funds to investments in urban areas to retain these customers and their implicit support. Rural telephone companies will continue to receive funding based on their actual costs for

serving high-cost areas. This will create a self-fulfilling prophecy of telecommunications "haves" and "have-nots," which is also totally inconsistent with the intent of the 1996 Act.

III. SPECIFIC ISSUES FOR COMMENT IN FNPRM

A. National Benchmark

1. General comments on the Joint Board's recommended range

As developed at the conclusion of the previous Section, the Commission must take care to manage the relationship between Rural and Non-Rural carrier support. Any significant divergence between Rural and Non-Rural companies risks differing levels of service for rural consumers. The Commission must also assure that the benchmark and the companion per-line limit on state contributions to the fund satisfy the "sufficiency" and "affordability" standards as delineated in the 1996 Act.

2. Level to set the National benchmark including comment on what additional factors and considerations we should take into account

Rough parity between Rural and Non-Rural would suggest that the benchmark should be at or near 115%. To the extent that the fund size must be managed, the benchmark should be temporarily moved up rather than arbitrarily adjusting the cost models or the geographic areas for targeting of support. If the Commission establishes a higher benchmark to avoid significant increases in fund size, then it must regularly review this level in light of evolving local competition. The proposed review in 2003 is too late.

B. Area Over Which Costs Should Be Averaged

1. Should support levels be calculated by comparing costs at the wire center, UNE cost zone level, or study area?

To efficiently target support where it is needed, costs should be aggregated at the smallest practical level. As you can see in this example, determining support at the wire center level will provide insufficient support to customers who are truly high-cost customers. Targeting universal service support at the study area is totally unacceptable. It does not provide sufficient explicit support as is required by the Act. UNE zones average costs over wide geographic areas and increase implicit support. They also have the same problem as wire centers since "support" will go to low-cost customers located near the COs as described below. U S WEST's analysis shows that even targeting support at the wire center will leave a significant number of high-cost U S WEST customers with insufficient universal service support and provide unneeded support to low-cost customers, thus encouraging uneconomic arbitrage opportunities for inefficient entrants. For example, the Farmington Main wire center (CLLI code: FRTNNMMA) in New Mexico serves approximately 24,900 lines in and around the Ute Mountain and Navajo reservations. The average monthly basic local service cost generated by the SM (6/2 Version utilizing the P500 Distribution algorithms) for Farmington Main is \$22.62. However, the cluster specific data generated by the SM, shows many clusters within the Farmington Main wire center that are extremely high-cost. Eight percent of the lines in the Farmington wire center have monthly costs in excess of \$48 per month and 2.5 percent of the lines have costs in excess of

\$100 per month. Thus, if calculated at the wire center level, the no-support zone would be awarded at the 115% benchmark; however, if the support is calculated within the wire center at the cluster level, the Farmington Main wire center qualifies for \$197,000 with a 115% benchmark and \$163,000 with a 150% benchmark. Moreover, as demonstrated in the companion U S WEST comments, the costs just discussed are generated with inputs and algorithms that severely understate the actual forward-looking costs of providing basic local phone service.

As you can see in this example, determining support at the wire center level will provide insufficient support to customers who are truly high cost customers. Given the current state of this docket, however, determining support at the wire center level (with the definition of an appropriate "no-support" zone as discussed previously) may be the best available alternative to support at the cluster level.

**2. Comment on Major benefits of deaveraged high-cost support –
1) ensures support to high-cost customers; 2) encourages
competitive entry in high-cost areas; and 3) removes more implicit
support**

The smaller the area of disaggregation, the greater will be the efficiency of obtaining support money for the consumers who need it the most. Arbitrage and scams where carriers sign up low-cost customers and reap a windfall of support based on average costs can be avoided through more specific targeting. When remote rural customers have a subsidy that, when added to the price, is closer to their actual cost, then more carriers will be incented to extend service to them. If

support is based on average costs at the wire center or a higher level of aggregation, then it is unlikely that any carrier will be willing to incur the very high-cost of constructing facilities to serve new customers in remote high-cost areas. In addition, higher levels of aggregation require the maintenance of implicit support flowing from urban to rural customers in the form of relatively higher urban prices and relatively lower rural prices.

3. How state UNE zones that do not correspond to wire center boundaries can be effectively used in the cost model?

Purchasers of UNEs should receive the benefit of explicit universal service support by having the UNE (loop) price reduced by the average per-line support amount for the UNE zone. By doing this it is not necessary that the UNE zones and the targeting area for support be exactly the same. It is more important that wholesale UNE zones correspond to the pricing zone utilized by the state for retail services pricing.

4. Impact of using study area averaged costs in a study area where UNEs are available – will the disparity of geo zones create incentives for carriers to engage in arbitrage or other uneconomic activities unrelated to the purpose of high-cost support?

Study area aggregation of support, by its very nature, encourages arbitrage. For example, in the state of New Mexico U S WEST receives an average of \$0.52 per month per line in high-cost support. This support is necessary to support services in high-cost areas of rural New Mexico. However, under a study area targeting approach, a competitive LEC who signed up a business in downtown Albuquerque would receive a windfall of \$6 per line annually. UNE zones would not pose a problem, particularly if U S WEST's proposal for UNE rates to be

offset by the average per line support were implemented. If support were aggregated at the study area level, however, then each UNE zone would have the unbundled loop price reduced by the study area per line support amount, which again would encourage arbitrage and discourage competition in remote, high-cost areas.

5. Ways to resolve the tension between the goal of preventing the fund from increasing significantly and the goal of ensuring that support is directly targeted to high-cost areas within study areas

As discussed previously, the goal of not having the fund increase significantly is a fundamental conflict with the Congressional mandate to provide sufficient support to assure affordable basic service and access to advanced services for all Americans. The “hold-harmless” provisions of the R&O further complicate this objective. One way to mitigate this tension if fund size is to be severely restricted would be to eliminate the hold-harmless provisions. Of course, the better way to resolve this tension is to allow the fund to be set at a sufficient level. The 1996 Act says nothing about the fund being the same size as before the introduction of local competition. Just the contrary, it does talk about sufficient funding for rural America in light of the introduction of local competition.

6. Comment on 4 proposals:

a. Determine support at study area, distribute at wire center

This approach is the least desirable of the four proposals. Determining support based upon Study Area averages of cost embeds significant amounts of prohibited implicit support in LEC rate structures.

b. Determine support at more granular level, but provide only a uniform percentage of support

This approach represents the second best solution. On the positive side, it targets support to the highest cost customers ensuring that the most needy customers receive the support. By only receiving some fraction of the necessary support, however, the Congressionally mandated “explicit,” “affordability” and “sufficiency” standards will not be met.

c. Determine support on costs averaged at a level more granular than study area, but cap the amount of support to a state to a fixed percentage of the overall fund

This approach is the second-worst option. The problem with this approach would be determining the amount of support that each state would receive. If each state’s cap were determined from the present support levels, then problems could result. Today, NRLECs receive a uniform 10% of their embedded costs over 115% of the national average. The remainder of support to high-cost areas is handled through implicit support and geographic rate averaging. States with large numbers of customers with costs in excess of 150% of the national average may not receive enough explicit support to maintain affordable service for their highest-cost customers.

d. Determine support at more granular level, but limit fund size by raising the cost benchmark or adopting incremental funding levels

Of the alternatives offered, this is probably the best option since it targets support to the customers who need it the most. Such an approach would be more successful in achieving the objectives of the Act if the hold-harmless provisions were removed and any necessary fund size constraints were applied at the national level. As stated previously, in order to meet its Congressionally

mandated duties, the Commission must determine the minimum necessary fund size to meet the standards of “explicit” support, “sufficiency” and “affordability.” As demonstrated in Chart I, this will require at least an increase in the fund to at least \$2.5 billion.

7. Respond to how all the above meet statutory requirements of sufficiency

None of the above meet the sufficiency mandate because of the two arbitrary constraints:

- Constraining the size to the current, monopoly-based fund size.
- Holding all states harmless for present fund receipts.

8. Additional methods for preventing the size of the fund from growing significantly

A minimum necessary fund size that accomplishes the intent of Congress could be determined as follows:

- Remove hold-harmless provisions.
- Determine necessary size of fund using areas that are geographically smaller than a wire center.
- Raise the benchmark and/or per-line contribution amount to reduce fund size, if necessary.
- With these modifications, what funds are available will go first to those high-cost areas most in need of funding to retain affordable service?

C. Determining a State’s Ability to Support High-Cost Areas

- 1. Should the per-line amount be set so that it amounts to between 3-6% of the \$31 revenue benchmark in order to roughly equal in absolute dollar terms the amount a state could reasonably have anticipated if measured on a revenue percentage basis? ¶111**

This amount, like any other number, is somewhat arbitrary. U S WEST would suggest that this amount, similar to the funding benchmark, is one more tool in the Commission’s arsenal to fine tune the fund size and assure its efficient

distribution. That is, in addition to moving the funding benchmark up, the Commission could also move the fixed amount per line up as a method to control the fund size. The impact of using this amount in this manner is illustrated on Chart I.

2. Should wireless lines be included in the calculation of the state's ability to support universal service? If included, should there be a distinction between wireless lines of an ETC and wireless lines of a non-ETC. ¶112

Wireless lines should not be included in the calculation of a state's ability to support universal service. It will be very difficult for a state commission, and perhaps the federal fund administrator, to determine how many wireless lines there are in a given state. How would a wireless line be defined? Would wireless companies voluntarily report to state commissions or to the federal administrator the number of "lines" it has in a given state? Administratively, it appears including wireless lines in a state's ability to support universal service would be a daunting and imprecise task.

Also, it is unreasonable to assume that all wireless providers will pay into state funds. In many states, wireless providers are arguing that they are not under state commission jurisdiction and cannot be required to pay into state funds. Recognizing that the Commission has determined wireless providers should contribute to state funds, this will not always be the case. In many states, strong wireless lobbyists propose and advocate state legislative language that exempts wireless providers from paying into funds until they seek and gain the ability to draw out of the fund. To assume in all states that wireless carriers are

contributing to a state's ability to cover its own high-cost customers would be an erroneous assumption.

D. Distribution and Application of Support

- 1. What specific restrictions are necessary to ensure support is used only for the provision, maintenance, and upgrading of facilities and services for which support is intended? Specifically, if support is determined at an area larger than a wire center, how do we require carriers to apply support to wire centers that triggered the need?**
¶113

The smaller the area to which support is targeted, the easier it will be to assure that the funds are used for their intended purpose – providing support for facilities to serve high-cost customers. “Targeting” support to the study area level has precisely the opposite result. A carrier can provide service only to customers in low-cost urban areas, yet still receive support payments (and receive a financial windfall). Even targeting support to the wire center poses problems in identifying the use of the support funds. Customers located close to the wire center are inexpensive to serve. It is the customer located many miles from the central office that requires support. A carrier who served only downtown customers would also receive a financial windfall. Assuring that funds are used for the intended purposes also is a reason why funds should only be given to the provider of the physical facilities. Resellers and purchasers of UNEs do not make the investment necessary to serve high-cost rural areas. Funds should go to the facilities provider, and UNE purchasers should receive a credit for the average per line support in the UNE zone.

- 2. Will making federal support available as carrier revenue to be**

accounted for in the state ratemaking process sufficiently fulfill 254(e) requirement? We tentatively conclude that making support available as part of the state ratemaking process would empower state regulators to achieve reasonable comparability of rates within their states. ¶114

Yes.

3. Do all states have the jurisdiction and resources this approach would require? ¶114

With respect to NRLECs most states would appear to have sufficient jurisdiction. In some states regulators do not have jurisdiction over RLECs, so this could be a problem if and when these carriers are brought under a similar type of program. State regulators have neither rate nor quality of service jurisdiction over wireless carriers.

4. Should carriers be required to notify high-cost customers that their lines have been identified as high-cost lines and that federal high-cost support is being provided to keep rates affordable? ¶114

No. This issue should be up to each state to decide. For example, in the state of Wyoming, where rates have been rebalanced to cover forward-looking costs, customers in high-cost areas with high rates see state high-cost fund credits on their bills. Not all states have rebalanced rates to the extent Wyoming has, and this type of credit would not be appropriate.

5. Should federal support be conditioned on state action to ensure support is being used in compliance with 254, or is certification sufficient? Should states that are unable or unwilling to take action allowed to refuse federal support. ETC ¶115

No. Support should go to the ETC providing support to the high-cost customer, not to a state commission. In an increasingly competitive environment, more

carriers will be deregulated and will not have state commission oversight.

Deregulation does not mean that the carrier should have support for serving high-cost customers denied. However, if a carrier receives universal service support, a state commission should have some oversight over wireless or wireline providers, regulated or deregulated to ensure that the universal services offered are reasonable and affordable. To the extent a state commission or the Commission believes a carrier is not using high-cost support appropriately, an audit of the carrier should be commenced. However, no carrier should be denied the opportunity to use funding appropriately, simply because a state commission is unwilling or determines it does not have the authority to oversee the carriers within its state. If the funding is denied to the carrier, it is the high-cost customer who is harmed.

6. What carrier or state commission action is necessary to prevent double recovery of universal service support at both the federal and state levels? ¶115

Similar to the operation of the present USF, any additional support that a state receives beyond what is currently being provided should be treated as a reduction in intrastate revenue requirements and an increase in interstate revenue requirements. States that use a price cap form of regulation should take any such increase as an exogenous price cap reduction.

7. If support is only a portion of support for given wire centers, how should support be allocated? Tentatively conclude that it should allocate the support among all lines in high-cost wire centers in a pro rata manner. ¶116

As mentioned repeatedly in these comments, the key to achieving the

Congressionally mandated universal service goals is to target support to the areas that need it the most. Pro rata allocation will not accomplish this in the most efficient manner.

E. Hold-Harmless and Portability of Support

1. Should hold-harmless be implemented on a state-by-state basis or carrier-by-carrier basis? ¶117

U S WEST believes that if hold-harmless provisions are to be included, that they should be applied on a carrier-by-carrier basis. We continue to believe that if the fund size is constrained to an artificially low level, then the hold-harmless provisions could frustrate the achievement of the universal service goals of the 1996 Act.

2. If state-by-state is adopted how should support be allocated among carriers in the event that the total amount of hold-harmless support provided in a particular state is insufficient to fully hold each carrier harmless? Comment on proposal outlined in. ¶120

The example presented in paragraph 120 of the R&O illustrates the futility of the Commission's and Joint Board's proposed hold-harmless provisions. The 1996 Act calls for "specific, predictable and sufficient" explicit support payments. The Act mentions nothing about holding carriers harmless for support payments developed under a monopoly market structure. It mentions nothing about funds being not significantly larger than total funds under the monopoly mechanism. The purpose of the fund is to support affordable service to high-cost customers. What if in the example two of the companies had large numbers of marginally high-cost customers, and the third company served several areas where the cost to serve customers was several hundred dollars per month. Should not the

majority of support go to serving the high-cost customers? When support dollars are scarce, they should be allocated first to the highest-cost customers. No other jerry-rigged method for allocating a limited amount of support will be consistent with the intent of the Act.

3. Should hold-harmless be distributed directly to state commissions rather than to carriers? ¶121

No.

4. Seek additional comment on distribution to state commission in the event a carrier(s) experience a reduction in support as a result of state-by-state hold-harmless. ¶121

U S WEST believes that support should go to where it is needed most. If support is limited, the funding benchmark and per-line state contribution should be adjusted until the desired fund size is reached. Any other plan is not consistent with the Act.

5. Relationship between hold-harmless and portability of federal high-cost support – should the competitor receive the hold-harmless amount or should they receive the amount of support determined on a forward-looking basis. ¶122

The competitor (as well as the incumbent) should receive support based on the forward-looking mechanism as adjusted by the funding benchmark and the per-line contribution.

F. Adjusting Interstate Access Charges to Account for Explicit Support

1. How to reduce interstate access charges to account for the high-cost support we determine shall be recovered instead as explicit high-cost interstate universal support. We emphasize in this section we are solely concerned with issues concerning support that is implicit in interstate mechanisms. Any support identified in interstate mechanisms is separate and distinct from federal support that may

be provided to ensure the reasonable comparability of intrastate rates. ¶123

Given the importance of access charges in maintaining universal service, the Commission cannot lawfully reduce access charges under its current proposal. In other words, since it appears that the Commission will establish a fund that merely maintains the status quo (rather than appropriately increasing explicit support to anywhere near the amount necessary to implement the Congressionally mandated support for affordable and advanced services in rural areas), the NRLECs will need to continue to rely heavily on all existing implicit support from services, including access charges. Given this reality, the Commission must refrain from access reductions unless it also changes course to obey the legally mandated principles of “explicit” support, “sufficiency” and “affordability.”

If the Commission were to change course and implement a properly sized fund and attempt access reform, then it must proceed first to determine the level of implicit support existing in access charges and in which access charge elements the implicit support resides and strategies for replacing implicit support with explicit. Until this exercise is complete, one cannot identify the mechanics for reducing interstate access rates to reflect incumbent LEC receipt of such support. However, as demonstrated repeatedly in these comments, the SM the Commission is continually modifying seriously understates the forward-looking cost of providing service. For this reason the SM is inappropriate for determining the amount of implicit support that currently exists in interstate access.

2. Tentatively conclude that price cap LECs should reflect explicit high-cost support by making the downward adjustment to their common line basket's price cap indexes (PCIs). ¶131

Such an adjustment should only be made if the carrier receives more support than under the present mechanism. If a carrier receives less support from the new fund due to restrictions on fund size or state hold-harmless exercises, then there should be an exogenous adjustment to the common line basket to increase the PCI to reflect the amount of the reduction. The Commission should apply any reductions due to increased implicit support to the multi-line business SLC and the non-primary residential line SLC. In placing large increases on these rate elements, the Commission was creating more implicit support within LEC rate structures at the very time when Congress was calling on them to reduce and eliminate implicit supports. Multi-line business customers are extremely vulnerable to competitive loss, and thus are the first place where reductions of implicit support must occur.

3. Alternatively, should incumbent LECs reduce access rates to offset the explicit support by lowering their common line charges on a geographically deaveraged basis. – For example deaveraged SLCs – should carriers be allowed to determine where they lower rates or should state commission determine? Should deaveraging be the same as UNE and interconnection deaveraging. ¶131

It is the position of U S WEST that wholesale services (UNEs) should only be deaveraged as the price for retail services is deaveraged. Thus SLCs and UNEs should only be deaveraged if and when retail services are similarly deaveraged.

4. Should common line rate elements be deaveraged? ¶131

Wholesale switched services, including common line rate elements, should only be deaveraged if and when retail services are similarly deaveraged.

- 5. Should price cap carriers reduce their base factor portion (BFP) for carriers that calculate their SLC on the BFP this would result in reductions to the SLC for multi line business and non-primary residential lines, which would be offset by smaller reductions in CCL and multi-line PICC rates. ¶132**

Yes. Multi-line business SLCs represent a form of implicit support which must be reduced if the intent of Congress for efficient local competition is to be realized.

- 6. Should a downward adjustment to the incumbent LECs PCIs be across-the-board instead of targeted to the common line basket? ¶132**

Reductions should be targeted to remove implicit support from LEC rate structures. For this reason reductions should not be applied across-the-board.

- 7. Should we reduce the SLC on primary residential and single-line business lines? Should we limit any reductions to the common line basket to the amount needed to reduce common line revenues per line to \$3.50? ¶133**

Prices should first be reduced on those rate elements which provide implicit support, and where such reductions will aid in the introduction of efficient local competition. Rather than reducing the primary and/or single line SLCs, reductions should be applied to multi-line and non-primary line SLCs.

- 8. Tentatively conclude that non-rural LECs should apply additional interstate explicit high-cost support revenues to the CCL Element thus reducing CCL Charges. ¶134**

U S WEST favors reductions in the BFP that would allow the reduction of multi-line business and non-primary residence SLCs. After all SLCs have been levelized at the appropriate level, any remaining support should be used to reduce first CCL and then PICC.

- 9. How do proposals conform to the Joint Board's guidelines? ¶134**

U S WEST's proposals are in concert with the spirit of the Joint Board's guidelines in that they reduce implicit support and encourage the development of efficient local competition.

- 10. Whether and how adoption of an access reform proposal that would direct more federal support to high-cost areas, relative to low-cost areas, should affect our calculation of high-cost universal service support, if at all. To the extent possible, parties commenting on this issue should address specific access reform proposals that could be used in this manner to reform both high-cost universal service and access charges simultaneously. ¶135**

As noted previously, because of the importance of access charges in maintaining universal service, the Commission cannot lawfully reduce access charges under its current proposal. In other words, because it appears that the Commission intends to establish a fund that merely maintains the status quo (rather than appropriately increasing explicit support to anywhere near the amount necessary to implement the Congressionally mandated support for affordable and advanced services in rural areas), the NRLECs will need to continue to rely heavily on all existing implicit support from services, including access charges. Given this reality the Commission must refrain from access reductions unless it also changes course to implement the legally mandated principles of "explicit" support, "sufficiency" and "affordability."

If, on the other hand, the Commission were to change course and implement a properly sized fund, then it may also attempt meaningful access reform. First, it must determine the level of implicit support existing in access charges and in which access charge elements the implicit support resides and strategies for replacing implicit support with explicit support. Until this exercise is complete,

one cannot identify the mechanics for reducing interstate access rates to reflect incumbent LEC receipt of such support. However, as demonstrated repeatedly in these comments, the SM the Commission is continually modifying seriously understates the forward-looking cost of providing service. For this reason the model is inappropriate for determining the amount of implicit support that currently exists in interstate access.

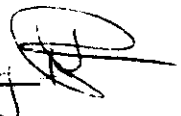
IV. CONCLUSION

The Commission's proposals represent a very dangerous inclination to ignore the universal service mandates of explicit and sufficient support in favor of the politically correct maintenance of the status quo. As such, they must be fundamentally reconsidered and reshaped to meet the requirements of the 1996 Act. The goals of hold-harmless and no increase in fund size must be abandoned, and the Commission

must take a fresh look at the evidence before it and craft a legitimate and lawful model and plan to see to it that federal universal service support becomes both explicit and sufficient.

Respectfully submitted,

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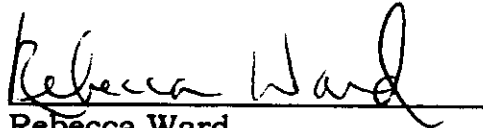
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July 23, 1999

CERTIFICATE OF SERVICE

I, Rebecca Ward, do hereby certify that on the 23rd day of July, 1999, I have caused a copy of the foregoing **COMMENTS OF U S WEST, INC.** to be served, via hand delivery, upon the persons listed on the attached service list.


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